This study by the staff of the Group of Thirty focuses on the crucible of recent experience, but set in a longer perspective. It is based partly on interviews with a widely representative selection of international bankers and supervisors to discover whether, in their view, debt problems might be better anticipated and handled in the future. However, it contains also detailed case histories of the recent Mexican and Brazilian negotiations published in that form for the first time, so far as is known, to illustrate two very different approaches to the restructuring of international market debt followed, to varying degrees, by other countries. The study includes also a review of experience gained over a quarter of a century in the Paris Club, in which debt relief is negotiated between governments, and the possible relevance of that experience for the banking system. In addition, there is a description of the aims of the newly founded Insitute of International Finance (the Ditchley Group) and the view which bankers take of that initiative, with special reference to the tensions that have arisen during recent debt renegotiations between larger and smaller banks.

Main findings

The following are the main findings of this study:

• A critical question is whether the present rash of international debt renegotiations with the banking system represents a *passing or enduring phenomenon.* A majority of those interviewed believe that while the present crisis has special and possibly unique causes, the damage may take several years to undo. The special circumstances are well known. A concerted disinflation initiated by the major financial powers from late 1979 to provide a basis for sustainable, uninflationary economic growth in the future, had a more brutal combined effect than intended by any single government. The impact was especially harsh because the main burden of counter-inflation was placed on monetary policy. The rise of nominal and real interest rates to exceptionally high levels and the accompanying stagnation of world output and trade over the three years through 1982 simultaneously increased the cost of debt and reduced the ability of debtors to service their obligations.

The impact has not been confined to sovereign borrowers by any means. The president of the World Bank, Mr. A. W. Clausen, recently pointed to the considerable pressures on businesses while also underscoring the familiar distinction between companies which can be wound up for creditors, and countries which cannot. He observed that in America alone about 53,000 businesses went bankrupt in 1982, "and a great proportion of their debt disappeared with them".*

*Jodidi Lecture, Harvard University, February 24th, 1983.

In the view of most bankers and supervisors who co-operated in this study, it is unlikely that the stretchings out of principal repayments recently negotiated or still in the course of negotiation will, of themselves, prove sufficient to restore the full debt-servicing capacity of many of the debtor countries. The recent negotiations have concentrated mainly on the stretching out, or restructuring, of repayments of principal falling due in 1982 and 1983. At the time of writing, the outlook for the global economy still remains uncertain. Even if the recovery in world output and trade now started is maintained, as hoped, a number of countries may still need to return to the bargaining table with their international bankers to renegotiate the terms of principal repayments falling due in 1984, those falling due in the year after and even, perhaps, in the year after that.

• Recent experience has provided a crash course in the *approach to rescheduling adopted by debtor countries*. That is why detailed case histories are provided here, on pages 23 to 30, of the very different ways in which Mexico and Brazil tackled their difficulties. The Mexican authorities acted with a suddenness and determination which struck many bankers as unnecessarily dramatic and even brutal at the time, but effective in retrospect.

By contrast, the Brazilian government and central bank tried to avoid facing creditors with a *fait accompli*. They were motivated by the well-intentioned aim of quietly winning creditors' confidence. In the view of most bankers and supervisors interviewed for this study, the Brazilian authorities deserve full marks for effort, but less for accomplishment. However, a majority of countries in recent external debt renegotiations with commercial banks have tended towards the Brazilian rather than the Mexican approach. Broadly speaking, Argentina and Peru are described as having followed the Mexican path, while Chile, Venezuela, Uruguay and Poland are said to have gone the Brazilian way towards restructuring.

Some approaches have been individualistic. In Jugoslavia's case, the government approached the International Monetary Fund which in its turn informally approached the country's main creditor banks acting in this case as a catalyst to get negotiations started rather than only in its more usual and public role of a catalyst in the adjustment process, designed to restore a member country's credit-worthiness.

Hungary was cited by some bankers as a country which had avoided restructuring its external debts partly by the "Brazilian approach" of taking its creditors into its confidence, but by doing so well before any difficulties threatened, instead of approaching its bankers only at the emergence of problems. The Hungarian authorities, who have, over the years, developed especially close relations with the western banking system, avoided even the taint of irresponsible behaviour by informally asking the IMF what kind of

programme the Fund might recommend if asked. The Hungarian government then adopted of its own accord an economic programme along the lines informally suggested to it, and was thus able to go on attracting new capital on its own merits.

• *The impact on banks* has been cushioned by a stiffening of restructuring terms during the past three years. Whereas in 1978 and 1980 principal was still being restructured over five to six years with two years of grace and at lending margins of 1¼ to 1½ per cent, recent restructurings, notably for Mexico and Brazil, have provided for longer stretch-out periods of eight years, but still with no more than 2½ years' grace and lending margins of well above 2 per cent, plus arrangement fees. This compares with margins of well below 1 per cent obtained by Brazil until 1980 and lending margins of ½ per cent available to Mexico as late as June 1982. In effect, creditor banks are being belatedly compensated for the very fine terms which they felt obliged to concede in the borrowers' market which persisted through most of the 1970s and into the early 1980s. If arrangement fees are taken into account, the restructured debt is yielding banks about 2 per cent a year more than the terms on which most of that debt was originally contracted. Moreover, during the grace periods, the banks obtain those yields on the total sums of restructured debt outstanding, because none is being run down during those years. On an admittedly very rough calculation, which takes into account that many of the leading banks obtain their funds at an average cost below Libor, banks may be earning about an extra $1¾ billion a year on the $90 billion of cross-border debt recently renegotiated or being renegotiated. Such earnings give banks more scope than in the past for making adequate provisions against full service and possible losses.

Far less welcome to banks has been the increasing tendency since 1979 to stretch out over several years principal repayments of short term claims originally extended for periods not exceeding one year. In such cases banks find themselves locked into positions far beyond those they had originally decided to take. All bankers interviewed expressed their resentment at this tendency, and especially regional and smaller banks which had made no medium or longer term commitments to borrowing countries. This resentment has found practical expression on the part of many banks, which have resisted pressure to restore interbank lines to troubled sovereign borrowers and declined to maintain even their full trade-related credits to such borrowers.

• *The kinds of debt* being restructured over the past three years has broadened, although stretching out is still confined mainly to principal payments. However, short term debt and even interest arrears have come to be included in restructurings, as already mentioned. Beyond that, a decision to go on excluding debt to international bond holders was carried only by a

single vote of the Mexican advisory committee early in 1982. The sums involved are not negligible. In the four years through 1982, developing and east European countries issued a total of more than $15½ billion on international bond markets including more than $8 billion issued by Mexico, Brazil and Venezuela and nearly $6 billion by Mexico alone. The servicing of bond issues has so far been allowed by major creditors to continue unimpeded because of the damage which might be caused by any interruption to confidence in international bond markets and the large number of individual investors in those markets, who have come to rely on a special protection of their interests, much like small depositors at banks. The large minority vote to include Mexico's bond obligations in the total of debt to be restructured, was viewed by some bankers as an attempt to secure equal treatment for all creditors, but also as a form of pressure on Swiss banks, which have a special interest in the smooth functioning of international bond markets, but which have allegedly been reluctant to maintain interbank lines and credit flows to countries in difficulties. The narrowness of the vote suggests that the sanctity of bond servicing can no longer be assumed with as much assurance as previously.

- The danger of outright *default* is dismissed by most bankers and supervisors who participated in this study. They do not believe that countries will risk their trade by defaulting outright. The point was strongly made by a senior spokesman of a large and advanced developing country. He said that if his country ever defaulted, its ships and aircraft everywhere would instantly be seized by creditors, as would any goods that his country tried to export. In fact, the only significant defaults which have so far occurred in the 20th century have been on the part of two countries which chose to withdraw or felt themselves excluded from the world community for protracted periods after 1917 in one case, and after 1949 in the other.

However, the majority view that countries will not default outright takes into account the difficulties which some borrowers may have in returning to creditworthiness as promptly as creditors would like. At the same time, it is proper to record the view of a minority of bankers who participated in this study and who do not wholly rule out the danger of default in cases where countries find it politically impossible to adjust on the scale and in the time sought by creditors.

While formally declared default remains an unlikely prospect in the view of the majority of respondents, *default by attrition* has begun to creep into the restructuring process. An example is provided by a small developing country whose debt, including some principal arrears and some interest arrears, has been restructured regularly during the past three years. While the debt is negligible for the international banking system and highly manageable even for the country's creditors banks, it is nevertheless large in

relation to the country's economy. Each year the debtor country fails to meet the restructuring terms in full and they are therefore negotiated once again. The time involved stretches the senior management resources of the creditor banks, who now delegate the annual restructuring negotiations to more junior personnel. The process, if continued, would eventually come to represent default in all but name, and some of the larger creditor banks would willingly write off their claims on the country excepting for their fear of the dangerous precedent that this might create. Indeed, they are concerned by the precedent already created.

- In the case of private sector debt, a uniform rule applies for *claims written off* by banks, whether the claims are on domestic or foreign borrowers. Such write-offs remove non-performing assets from the books of the banks, but they are not synonymous with money lost for all time. It is common for banks to recover a large part of loans they have written off, even though the process may sometimes take years.

The main *information gaps* cited by nearly all respondents were timely information on short-term credits of up to a year, including trade-related and interbank credits. But all of them acknowledged the extreme difficulty of obtaining such information in any useful way from highly fluid markets.

For instance, a European bank supervisor pointed out that short of daily reports on interbank positions (impossibly costly), the usefulness of quarterly, monthly, or even weekly "snapshots" would be vitiated to the extent that banks learn to cover their positions for the relevant reporting dates.

- Several respondents admitted that *information gaps* existed as much *within their own banks as in the system*. For example, one European bank reported a shift in its interbank claims on Brazilian banks from $2 million to $30 million in a single day. Another bank mentioned the example of an African bank which had raised $500 million from small bank participants in the interbank market over a period of weeks without any awareness on the part of its bigger creditor banks that it was doing so. The information gaps existing within banks were graphically illustrated by a European banker who said that he would not have sanctioned a further growth of interbank credits to Mexico as late as June 1982 had he been informed of the extent to which they were building up. Closer questioning revealed, however, that the information had in fact been known to his subordinates, but not passed upwards. "If the figures had been brought to my attention, I would surely have acted differently," he said.

- Several respondents said that present difficulties had provided a salutory reminder of the *need for judgment* rather than ever more statistics, whose sheer mass and inevitable deficiencies can indeed provide the timid with an excuse for postponing judgments indefinitely. A number of bankers

made the point that the soaring cost of debt and the stagnation of world output and trade should in themselves have provided early warnings that many sovereign borrowers would run into difficulties, especially those with large amounts of market and floating rate debt. One banker said:

> "Banks would not have acted differently had quicker detailed information been available to them. What is important is not only information, but how we react to it."

- One indication that the market continued to concentrate on the perceived *outlook for individual countries* rather than the gathering difficulties threatening all large market borrowers is provided by the difference of terms to Brazil and Mexico before the crisis. The cost of new money in the international bank loan market began rising for Brazil as long ago as mid-1980 and by late 1981 had already reached the levels subsequently incorporated into restructuring agreements. Mexico, by contrast, was still obtaining new medium term bank loans at a mere ½ per cent above Libor as late as June 1982, on the mistaken assumption that petroleum prices were uniquely immune from the forces of supply and demand.

While recognising the limitations of ever more information flows in themselves, respondents nevertheless stressed the need for the provision of fuller information by debtor countries and more efficient monitoring by the supervisory authorities of banks in creditor countries. For example, many of the 98 countries reporting their medium and long term debt to the World Bank do not include private non-guaranteed debt. Mexico is prominent among those which have not so far done so, and the staff of the Bank has found a close relationship between countries which provide inadequate information and those that run into difficulties.*

- The difficulty of adequate debt reporting in borrowing countries is recognised as being partly political and not just technical. The reason is that prompt and comprehensive information on the volume and tenor of new debt contracted by the public and private sectors can be obtained only where *national information-gathering agencies are* given sufficient political independence and authority to command the supply of information and to face their governments with the facts, welcome or otherwise. The political sensitivity of such a role is believed to have impeded fuller information flows from a number of debtor countries.

In one sense, complete information becomes more important in the event of a crisis than in anticipating difficulties, because trouble can be foreseen even when the last number is not known. However, when the renegotiating of debt actually begins, it becomes imperative to know exactly what is being renegotiated, and precisely how much is owed for how long and to whom. This is where practical difficulties often arise. The volume of

* World Debt Tables, 1982-83, and World Development Report, 1983, IBRD.

Mexican private sector debt to external creditors to be included in that country's restructuring negotiations was officially estimated only eight months after full debt service had been suspended and in Brazil's case, the total being negotiated still remained unknown in June, 1983, although that country's difficulties had begun to emerge in August 1982.

• Most respondents said they would like a still further improvement of relations with international agencies, especially the *International Monetary Fund* and the *Bank for International Settlements*. However, limitations were also mentioned.

The Bank for International Settlements, which has periodically provided bridging finance, for instance, to the United Kingdom in 1976 and more recently Hungary, has said that its limited resources might not allow it to go on providing large bridging financing for non-member countries, as it did for Brazil and Mexico in 1982, and for Chile in May, 1983. Commercial banks look to the BIS mainly for a continuing improvement of information on the terms and structure of cross-border debt as reported to the the BIS by the central banks of the main financial market countries. However, they reported an inhibition about making direct contacts with the BIS, which they regard as the central bankers' bank (by contrast with the ease of informal contacts reported to exist with the staff of the IMF). In addition, commercial bankers see the BIS as filling a useful role in providing the forum in which bank supervisors of the main creditor countries have been meeting for several years to try to harmonise supervisory practices. The deficiency seen in present arrangements is that the understanding among member countries of the BIS on the division of responsibility for bank supervision between host and parent countries of international banks still lacks any clear understanding about division of responsibility for the solvency of foreign branches and subsidiaries.

Bankers interviewed have attached new importance to the International Monetary Fund as a catalyst in the restructuring and adjustment process. This dates back some years to the failure of programmes presented to and reviewed by creditor banks for Peru in 1976 and Nicaragua in 1980. Since then, banks have attached increasing value to adjustment programmes agreed by borrowing countries with the IMF itself.

The response has been more mixed to the newly active role played by the IMF in 1982, when it made complementary bank financing a condition of programmes agreed with Mexico and Brazil on the little publicised precedents of complementary financing provided by the banking system and the IMF to Togo in 1980 and the Sudan in 1981.

• Broadly speaking, the large international banks have welcomed the efforts of the International Monetary Fund, strongly supported by the American Federal Reserve System and the Bank of England, among others, to

maintain flows of finance from the banking system to borrowing countries experiencing difficulties. However, many regional and smaller banks have expressed some resentment and have actually resisted what they regard as unjustified pressure to go on lending. Moreover, some large banks, while welcoming the role of the IMF and other authorities in helping to maintain credit flows to countries where those banks themselves are heavily exposed, have said they would resist similar "arm-twisting" in the case of countries where they do not have substantial exposure. Reflecting the ambivalent attitude of several banks to the IMF's new approach, a major US bank said that while applauding the IMF's role in Mexico and Brazil, it would not comply with similar requests to go on lending to eastern Europe, where it is relatively less exposed.

A European banker said:

> "At first I thought Mr de Larosiere's methods were shocking. However, on reflection, it was the only way to proceed. But, quite frankly, our willingness to participate in such exercises in the future might be limited by our lending capacity."

Bankers responding to this survey spoke favourably of relations with the staff of the IMF, and staff reports to the IMF executive board have for very long been widely "leaked" to the banking community, although there is no suggestion that this has been done by the staff of the IMF. Such reports are usually circulated among banks either by the governments of the debtor countries themselves or through the authorities of the creditor banks' host countries. However, justifiably or otherwise, a number of bankers believe that staff reports and IMF adjustment programmes are often based on incomplete and even misleading information obtained from the authorities of borrowing countries. The bankers interviewed do not necessarily attribute such misinformation to bad faith, and certainly not in all cases. But they do suspect that the value of staff reports and the viability of adjustment programmes agreed with the IMF may be equally vitiated in some cases. Not only bankers, but some *supervisors* too, said that they would like a closer relation with the IMF. One of them said:

> "What we need as supervisors is to have better view of the IMF's perception of different countries."

Respondents were divided, not only numerically but often in their own minds, about the balance of advantage of fuller disclosure by debtor countries to the financial system through the IMF. On the one hand, many respondents believe that IMF insistence on complementary financing imposes a duty on the Fund to provide the banking community with fuller information on member countries thus assisted, with the consent of the countries. However, there are many who believe that this would tend to inhibit disclosure by member countries to the Fund.

• The evolution of the *Paris Club* (see details on page 31) provides some guidance for the restructuring of cross-border debt. The "club" is the forum

in which the governments of debtor countries and the governments of aid-donating countries have renegotiated the terms of intra-government debt since 1956, and a body of precedent and unwritten rules has evolved over the years. Yet its evolution has been a reluctant one at every stage. The appointment of a secretariat was resisted for almost 20 years. The workings of the "club" have seldom been fully spelled out in public, and even references to the "club" are only grudgingly tolerated by the creditor governments. The explanation is the understandable reluctance to formalise, or at least admit to any formalisation of restructuring procedures, for fear of inviting more restructuring applications.

Most commercial bankers interviewed for this survey take a similar attitude towards any attempt at developing a more "structured" approach towards the renegotiation of cross-border debt to the financial markets. They, too, are concerned that the evolution of a set of restructuring rules might have the effect of inviting more applications for debt renegotiation.

However, in spite of the long reluctance of the Paris Club to become a club, it has nevertheless evolved into one. Its rules require debtor countries to agree an IMF adjustent programme before requests for relief are considered, the creditor countries have tried, though without total success, to limit restructuring to the principal repayments due within a two-year period at most, and have tried to oblige borrowing countries to renegotiate debt to other creditors on the same terms as those applying to debt restructured within the club. In spite of that, the rules have had to be eased over the years. Arrears of principal and even interest are now sometimes included in restructurings. Relief is often given on principal repayments due in succeeding years, and a conditional undertaking to consider further relief in the future is often given by creditor governments if the debtor country can show at the next negotiation that it is continuing to adjust its economy on the lines agreed with the IMF.

• International debt to the banking system differs so widely from case to case in structure, tenor and the composition of the creditor banks that there could be *no common systematic approach to restructuring* as in the case of sovereign debt to a limited number of sovereign creditors, even if banks and borrowing countries desired such a thing. It is not only banks which would resist an evolution towards a more formally structured approach. Debtor countries themselves showed that they were opposed to the concept of any generalised debt renegotiations with creditor countries on common terms at a meeting in early 1983 of UNCTAD, the United Nations Conference on Trade and Development. The reason for this reluctance was the obvious wish of borrowing countries to maintain differences of creditworthiness between themselves and to strive individually for the highest credit ratings and most favourable borrowing terms available to each of them in any given

set of circumstances.

• While the process of renegotiating cross-border debt has not so far become more structured in any recognisable sense, *the approach of banks* has almost imperceptibly been influenced by experience predating the latest concentration of sovereign debt reschedulings. An American banker put this into perspective by observing that the renegotiation of corporate debt is a matter of routine in the United States and, because American companies usually have several bankers and in addition rely on loans that have been syndicated in the domestic market, the renegotiation of corporate debt is often undertaken under the leadership of some of the creditor banks acting for all.

While banks in other leading industrial countries also restructure corporate debt as a matter of routine, the debt thus restructured is more often syndicated debt in the United States than in many other countries. The American banks, which have taken the lead in the restructuring of South American debt recently, are therefore perceived by many European bankers who were interviewed as having more practice in leading such restructuring groups. American leadership of restructuring groups was therefore welcomed by several European bankers taking part in this study, even by some who complained at the same time of the "bullying tactics" used, while also acknowledging the practical usefulness of such tactics.

• In practice, advisory or steering groups managing the restructuring of sovereign debt to banks have been led by those banks having the largest exposure to the debtor countries, in other words, the same banks that took the lead in the lending process. While some of those interviewed showed a certain resentment at having a handful of international banks at the head of most or many renegotiating groups, several others welcomed this situation on the ground that those banks were acquiring growing skill and experience of debt restructuring.

On the other hand, a number of *regional and smaller banks*, who were happy to follow the lead and judgment of the major international banks when they first entered the international medium-term lending market, have come to feel aggrieved at their subordinate position in the restructuring process. This attitude was strongly expressed by regional and smaller banks interviewed in the United States. A typical comment from an executive of a smaller banks was: "We simply get a telex from the steering group banks that they are meeting in Zurich or wherever, that they have agreed on such and such terms, and would we kindly telex our agreement by no later than 2 p.m."

The sense of grievance thus expressed is not in all cases impotent. The banker cited above said that his bank had refused to restore its total facilities to Brazil to the levels of June 1982, plus an additional percentage, as requested by the IMF and the Federal Reserve System. He went on to say that

if the borrower retaliated by paying interest on his bank's remaining claims below the common penalty spread, it would seek redress from other syndicate banks under the "sharing clause" of rescheduling agreements.

Executives at major international banks are less than deeply moved by the present grievances of smaller banks which, in their view, having been happy enough to enter the markets in a subsidiary role when the going was good, should not complain at times of adversity.

In practice, smaller banks may prove less cooperative in the restructuring process because their entry into international lending was often influenced by the desire for closer links with lead managing banks rather than the wish for closer relations with the borrowing countries. By contrast, the managements of the smaller banks are more concerned with the attitudes of their directors and shareholders than their relationship with bigger banks in the colder climate of debt restructuring.

• Bankers who cooperated in this study were unanimous in saying that uniformity in making *provisions* against bad and doubtful claims was neither desirable nor possible, partly because of differences of auditing standards and tax treatment of provisions in the host countries of creditor banks. More important, perhaps, is the view strongly expressed by several bankers and some supervisors that the level of provisions is a matter for each bank to decide for itself on its own view of prudent conduct.

A European banker said:

> "If you take the responsibility for deciding provisions away from individual banks, you weaken their approach to all of their lending."

An allied point made by an American banker was that any official pressure on banks to make provisions exceeding their own view of prudent levels would undermine their ability to provide incremental financing to sovereign borrowers in difficulties. Yet another objection to uniform levels of provisions was raised by a European banker who pointed to differences in the capital structure of individual banks. He said:

> "Banks with a relatively large capital base can safely make relatively smaller provisions than those which have relatively small equity and should therefore put aside larger provisions than other banks."

An assertion made by several commercial banks was that US supervisors were politically influenced by the State Department in their assessment of claims held on sovereign borrowers by American banks. This was strongly denied by all the US supervising agencies.

• Recently a number of proposals have been made for *official guarantees* of cross-border lending or for schemes which would enable banks to sell at a *discount* some of their restructured cross-border claims. At the commercial level, at least one investment bank has actively started exploring the possibility of helping to create a market for such discounting. At the theoretical level, proposals have been made for discounting facilities to be

offered either by central banks of the major market creditors acting individually or, alternatively, through some international initiative.

However, a number of difficulties were stressed. At the extreme, one European banker described all such proposals as "dangerous nonsense". Another said, "Where is the central bank that would be willing to take non-performing assets onto its books?" And, a banking supervisor drew an important distinction between occasionally and temporarily discounting the paper of an individual bank to tide it over a liquidity difficulty, and any generalised schemes for discounting cross-border claims of commercial banks.

An underlying risk is that if national authorities acted individually to provide some generalised form of guarantees or discounting the cross-border claims of banks in their jurisdiction, each country might do so on different terms. In that case, the outcome might be a financial equivalent of the undeclared trade war that has evolved through the competitive subsidisation of export credits.

An international initiative to provide guarantees or discounting facilities through some cooperative approach would avoid such a risk, but might lack motivation for precisely that reason. Moreover, the negotiation for the creation of an international discounting facility might be drawn out indefinitely in the absence of a crisis and prove impossible in the heat of a crisis – a crisis being defined here as a large accumulation of repeated cross-border market restructurings.

The discounts at which commercial bank claims are taken over will either reflect the realities of cost and risk by being pitched at market levels, in which case banks may have no particular inducement to take advantage of the facility. Alternatively, if the rates of discount are not pitched at market levels, resistance may be encountered from the electorates of creditor countries, and banks might be reluctant either to face such resistance or to pay for it by some loss of their independence.

From the point of borrowing countries, a system of official discounting might be equally unattractive whether at subsidised or market rates. More credit-worthy borrowing countries, especially those that have avoided restructuring, might feel their competitive edge as borrowers being blunted in the case of officially subsidised discounting facilities at uniform rates. In the case of official discounting at market rates, weaker borrowers would dislike a new and publicised measure of their credit rating, although that would provide an extra spur which would be in the borrowers' own interests.

The last named issue would arise equally in the case of officially sponsored discounting schemes and any form of discounting spontaneously created in the markets. That need not deter private initiatives for the creation of a discount market, but it is difficult to envisage such a

market evolving at any easily foreseeable time to a size enabling it to absorb anything more than the claims held by some smaller banks. That much, however, might be welcomed on all sides.

• In confidential interviews bankers expressed as many reservations about the *Institute of International Finance* (the Ditchley group) as hopes for it.* On the positive side they welcomed its possible usefulness as a centre for gathering and disseminating information in a neutral way. Yet a number of bankers, especially in Europe, viewed this unarguably laudable function with some scepticism. They questioned whether the Institute would in fact be able to add significantly to the volume of information already available, whether more information itself would be especially useful, and whether the group might not help precipitate rather than prevent difficulties. If it really succeeds in persuading debtor countries into a more open attitude towards all creditor banks. The Swiss banks as a group hesitated to join the IIF until persuaded to do so by the Swiss National Bank.

Some other European bankers said they would join the IIF only because it might "look odd" if they did not, and several other dismissed it as a "sop" to regional and smaller banks, especially in the United States. Some bankers were as much concerned about the possibility that the IIF might acquire real influence as by the belief that it might prove ineffectual. Aside from the risk already mentioned, that the mere dissemination of more information on debtor countries could have the perverse effect of hastening rather than preventing difficulties, one European banker expressed the fear that the Institute might soon find itself acting in fact even though against its expressed wishes as a perceived credit agency. In that case, he added, such credit ratings or perceived credit ratings might be used by bank supervisors in classifying cross-border loans on the books of banks in their jurisdiction.

Some recent lessons

Some of the important lessons learned from recent experience include the following:

- Those commercial banks which had tended to assess sovereign borrowers in isolation have been forcefully reminded of the need to view such borrowers in a wider context. Even inherently viable borrowing countries have encountered difficulties in maintaining full service of their international debt because of the high real interest rates and economic stagnation of the global disinflation of 1979-82.
- While information gaps, especially on short-term credit flows, remain a matter of legitimate concern to creditor banks, there has been a renewed recognition of the need for the exercise of more

*See also page 34.

judgement in the international lending process.

- When countries do run into debt-servicing difficulties, the prompt and even dramatic reaction exemplified by Mexico has seemed more efficient than the well-intentioned approach of some other countries, notably Brazil, which lost time and money by engaging in long informal discussions with creditors before suspending full debt service.
- Cross-border debt renegotiation by commercial banks has not and is unlikely to become, a structured process, as in the case of intra-government debt renegotiations within the Paris Club. However, experience gained in the Paris Club and in the routine renegotiations of syndicated domestic corporate debt in the United States has provided some valuable guidance for creditors and debtors in the renegotiation of cross-border debt to the commercial banking system.
- Experience in the Paris Club has shown the difficulties of compromising between conditions too lax to induce sufficient adjustment by borrowers and too harsh to be met. That difficulty has been partly addressed by arrangements under which creditor governments undertake to consider favourably further applications for debt restructuring provided the debtor countries continue to adhere to the adjustment programmes agreed with the IMF. Although commercial banks have not and may not follow that precedent in an openly declared way, they have come to recognise that it may take several years for some countries to be able to resume full debt service, even on the most promising view which can reasonably be taken of the world economic outlook at this juncture. However, there is a widespread belief that the worst initial "shock" of cross-border debt renegotiation with the commercial banking system has been absorbed more smoothly than many critics believed possible even as recently as mid-1982.
- The new and more active involvement of the International Monetary Fund, the Bank for International Settlements and national authorities like the Federal Reserve System and the Bank of England provides concrete evidence of the need for a closer and more coordinated approach as perceived by creditors, bankers and the authorities alike, in the interests of maintaining the viability of the banking system as a major and indispensable channel for the flow of funds from surplus to deficit countries.
- The formation of the Institute of International Finance (the Ditchley Group) recognises the importance attached to a fuller and closer dialogue between commercial banks and borrowing countries. It recognises also the need to give greater recognition to the increasing and valuable role in the international lending process played by regional and smaller banks.

Two approaches to restructuring: Mexico and Brazil

In the latter part of 1982 and the first half of 1983, Mexico and Brazil restructured record amounts of external debt owed to the international banking system. The sums were about $35 billion in Mexico's case and about $5 billion in Brazil's, compared with previous records of $4.8 billion set by Poland in 1982 and $3 billion by Turkey in 1979.

Mexico and Brazil followed similar paths in some respects, but not all. Excepting for relatively minor interruptions of service by some private sector borrowers in the two countries, Mexico and Brazil both maintained full external debt service until they suspended it to nearly all creditors.* In the case of both countries, the bulk of debt renegotiated was public sector debt and the restructuring was confined almost entirely to a stretching out over six to eight years of repayments of principal due to have been made in 1983 and 1984. Both countries agreed to adjustment programmes with the International Monetary Fund which, for the first time, made substantial complementary new financing by the banking system a condition of providing assistance of its own.

However, the differences of the approaches adopted by Mexico and Brazil are instructive, and explained only partly by the initial belief that Brazil was suffering merely a "contagion" from Mexico.

The Mexican authorities acted with a suddenness which at first took the financial community aback, but which over time began to provide the assurance of a business-like approach. A moratorium on the repayment of nearly $20 billion of principal of public sector debt due to international banks and the appointment of a centralised advisory committee of creditor banks were announced on the same day, namely August 20th, 1982. Terms for the restructuring of the suspended repayments were likewise proposed on the same day and bridging finance from the American government and the Bank for International Settlements was announcing two days later.

Within ten days, foreign exchange controls were imposed, which impeded the servicing of Mexican private sector debt, but which also stemmed flights of 'hot money', a move viewed by many bankers interviewed for this study as coming late but, at least, better late than never.

At the same time the Mexican authorities enlisted the support of the Federal Reserve System and the Bank of England to persuade the financial community not to reduce interbank lines to Mexico, a preventative move

* An important exception in the case of all countries is that debt to the World Bank is always serviced promptly and in full, because of the Bank's inflexible policy of treating any interruption of service as a default, which threatens to force borrowers into default to all creditors under cross-default clauses.

which contrasted with the Brazilian approach of trying to restore interbank lines only after they had first been heavily eroded. The persuasion of the financial community to maintain credit to Mexico in the interbank market took the form of what was authoritatively described in interviews for this study as "heavy pressure" on international banks. But, aware of the uncomfortable precedents set during the impasse over the American hostages in Iran in 1979 and 1980 and during the South Atlantic war in 1982, great care was taken to avoid the impression or threat of any freezing of interbank lines.

In dealings with the International Monetary Fund, the Mexican authorities agreed from the beginning that the managing director of the IMF should seek complementary bank financing.

The essence of the Mexican approach was an instant moratorium, the simultaneous appointment of a single advisory committee to represent all creditor banks, the prompt arrangement of bridging finance, a delayed imposition of exchange controls, but one which was not delayed excessively, prompt action to maintain interbank lines, and clear proposals at each stage for the amounts and terms of debt being restructured. Moreover, having imposed foreign exchange controls which impeded the external debt servicing of Mexican private sector debtors, the Mexican central bank very soon made arrangements for taking over the foreign exchange liabilities of those debtors. This made it possible for foreign bank supervisors to classify such loans on the books of banks in the United States and elsewhere as "performing loans".

Brazil acted very differently. Its difficulties began in the interbank market as early as August, 1982, but the first official announcement by the authorities was made only on October 25th and, even then, it promised an approach for conditional financing to the International Monetary Fund only after the elections to Brazil's federal assembly on November 15th.

Throughout November, the president of the Brazilian central bank sounded out banks in the United States and Europe, seeking up to $6 billion of new financing, while also entering into preliminary discussion with the IMF.

It was not until December 20th, 1982, that the Brazilian authorities invited some of the banking community to represent its creditors in the negotiation of a restructuring of its debt, and even then four groups of representative creditor banks were created instead of one. Each of these four was given a distinctive task. The first was asked to raise almost $4½ billion of new financing for 1983. The second was asked to reschedule $4 billion of principal repayments due in 1983, mainly of public sector debt. A third group was appointed to try to persuade the financial community to restore trade-related bank credit lines, while a fourth was given the task of trying to

persuade the financial community to restore interbank lines to Brazil to their level at mid-1982.

The main difficulties encountered by the four groups appointed at this very late stage were that their functions overlapped and even conflicted to some extent, and that they were being asked to address problems which had become more acute during the delay in making a formal approach to commercial bank creditors through clearly identified representative banks. For instance, Brazil was trying to claw back large lines which had been reduced in the interbank market, a far more difficult exercise than Mexico's prompt action in putting strong pressure on the markets to maintain those lines from the start, an exercise in which it received considerable help from the American Federal Reserve System and the Bank of England.

New financing was agreed with the banking community only on December 31st, and the sum was $2.2 billion, or little more than a third of the amount of up to $6 billion ambitiously being sought only a month before. Four days later, having obtained new financing, the Brazilian authorities finally acted to suspend the repayment of nearly $5 billion (revised upward from $4 billion) of principal repayments due in 1983 on public sector debt to the international banking system. This suspension, coming immediately after an agreement on new financing, created an unfavourable impression on the markets, according to many bankers and supervisors interviewed for this study.

The impracticability of trying to handle the problems of Brazil's debts to the international banking system through four distinct representative groups of banks was implicitly recognized on January 24th when a single centralized committee of creditor banks was formed for the first time, a full five months after the first signs of difficulty. The first meeting of that centralized committee at premises provided by the Bank of England reflected some of the confusion which had now arisen. Some of the sixteen banks invited did not send representatives. On the other hand, a number of other banks sent representatives, uninvited, because of their membership of the four advisory groups created a month earlier, but now dissolved.

On the same date, the managing director of the International Monetary Fund explicitly made the restoration of interbank lines to Brazil a condition of IMF assistance to that country, representing a shift from the 'voluntary' approach which the Brazilian authorities had previously been hoping to achieve. Throughout this period, the Brazilian finance ministry and central bank had also tried not to interfere with market forces by imposing only partial exchange controls to allow the servicing of private sector external debt, although some such servicing was in fact interrupted.

In the view of many bankers and some supervisors interviewed, the well-intentioned attempt by the Brazilian authorities to go on allowing free play to

market forces in the interbank market and partly on the exchanges did not succeed in its aim of maintaining market confidence. On the contrary, by hesitating to act more promptly and decisively, the Brazilian authorities allowed the external debt situation to worsen and, justifiably or otherwise, conveyed an impression of indecisiveness to the foreign creditor banks which they were seeking to reassure.

Mexico's debt restructuring, 1982-83

1982

August 20:

The Mexican authorities invite 12 international banks (later increased to 13) to form an advisory committee and meet representatives of those banks in New York to propose a 90-day moratorium on the repayment of about $19½ billion of principal of public sector debt due to about 1,400 banks in 1983.

August 22:

The Mexican finance minister telexes coordinating banks in the major creditor countries and the key US regional centers, informing them that the US government is providing $1 billion in prepayment for imports from Mexico plus a bridging facility of $925 million and that the Bank for International Settlements is providing a similar $925 million of bridging, pending the negotiation of an agreement by Mexico with the International Monetary Fund. The banks thus informed, a larger number than those comprising the advisory comrnittee, are asked to pass on the information to all the approximately 1,400 banks involved.

August 23:

The 90-day moratorium proposed three days earlier goes into effect.

September 1:

Mexico announces foreign exchange controls and bank nationalization. This former constrains the ability of Mexican private sector debtors to service their external debt, even in the case of Mexican companies which are themselves earning enough foreign exchange to go on meeting their external obligations.

November 16:

The managing director of IMF meets representatives of the 13-bank Mexican advisory group at the New York Federal Reserve Bank and indicates in general terms the net financing that will be required from the commercial banking system to complement IMF assistance to Mexico. This is the first time that the IMF has sought large complementary financing from the banking system as an essential part of an agreement with a member country.

November 23:

The Mexican authorities extend to 120 days the 90-day moratorium that went into effect from August 23rd.

December 1:

Spelling out his initial request of November 16th, the managing director of the IMF asks the Mexican advisory group to obtain written commitments by December 15th from all of Mexico's creditor banks or as many as possible for a total of $5 billion of complementary financing.

December 8:

The Mexican authorities telex the 13 banks of the advisory group proposing terms for the $5 billion of complementary financing in the course of arrangement. The request is for financing of 6 years with 3 years' grace at a fee of ½ per cent and with a margin of 2½ per cent above US prime.

At the same time, Mexico telexes to the advisory committee its proposals for rescheduling all of the approximately $19½ billion of principal repayments due on Mexican public sector debt to foreign commercial banks between the moratorium of August 23rd, 1982 and the end of 1984. The terms are for a restructuring over 8 years, with 4 years' grace, a fee of 1 per cent and a lending margin of 1⅞ per cent above Libor or 1¾ per cent over US prime.

December 20:

The Mexican government announces that Mexican private sector companies may pay the peso equivalent of external debt service into the central bank of Mexico, which will assume the foreign exchange liability to external creditors.

The American supervisory authorities agree to classify Mexican private debt thus treated as constituting "performing loans" on the books of banks in the US.

December 23:

The IMF executive board approves 3-year assistance of the equivalent of about $3.8 billion under the Fund's Extended Finance Facility and Mexico's first credit tranche.

1983

February 10:

The Mexican central bank disburses to international banks an initial $60 million in payment of arrears of service on behalf of Mexican private sector debtors.

February 24:

Loan agreements are drafted in New York for $5 billion of

complementary financing to be provided by about 1,000 international banks on the terms proposed on December 8th.

February 28:

Mexico proposes a restructuring of non-guaranteed public and private sector commercial debt as well as of officially guaranteed private sector commercial debt owed to the international banking system. Principal and interest on suppliers' credits contracted before December 20th, 1982 and falling due up to June 30th, 1983 may be deposited in dollars obtained at a controlled exchange rate by borrowers at the Bank of Mexico. The central bank undertakes to make payments to foreign creditors on conditions to be decided after July 15th, 1983 in the light of the foreign exchange then available and the maturity and size of the outstanding debt. The terms are then to be announced on August 15th – representing the date to which the original moratorium on public sector debt is subsequently set to expire. In restrospect, this is viewed by the market as the first intimation of a subsequent restructuring negotiation in the late summer of 1983.

March 17:

The Mexican authorities ask for an extension from March 23rd to August 15th, 1983, of the moratorium originally declared on August 23rd, 1982 and extended on November 23rd on $19½ billion of principal repayments due to international banks on Mexico's public sector debt to the end of 1984.

April 6:

The Bank of Mexico announces that schemes to cover a total of $15 billion of private sector external debt to banks and other foreign creditors will incorporate earlier proposals but will apply only where creditors agree to restructure the principal over a minimum of 6 years with 3 years' grace. Service on this debt is to be paid into the Bank of Mexico by debtors and the foreign exchange risk is to be covered by a Mexican government trust fund. Applications from debtors and creditors to take part in this scheme will be received up to October 25th, 1983 – another indication that debt renegotiation may become protracted.

April 12:

The terms proposed on December 8th, 1982 for $5 billion of complementary financing and the restructuring of $19½ billion of public sector debt still not approved. The latest date for their approval is officially reported to be August 15th, 1983.

April 15:

M. Michel Camdessus, the Chairman of the Paris Club, formally telexes the Mexican authorities for clarification of their treatment of officially guaranteed private sector debt.

April 21:

Mexico and Spain sign an MOU, or memorandum of understanding, covering the refinancing of all Mexican private and sector debt owed to Spain (other than non-guaranteed loans owed to banks).

April 26-29:

At the Mexican-Brazilian presidential summit meeting in Cancun, Mexico, to discuss bilateral economic relations, the authorities of both countries deny press reports that the meeting was "to discuss a contingency plan ... to join forces in pressing the IMF and the world's banks into accepting their own more favourable terms for repayment of their foreign debt".

May 6:

The finance minister, Mr Silva Herzog, telexes M. Camdessus with formal proposals to refinance all officially guaranteed private sector debt outstanding at December 20th, 1982, over a minimum of 6 years.

May 23:

The IMF board formally acknowledges Mexico's compliance with all its first-quarter performance targets under the SDR 3.4 billion EFF, or Extended Finance Facility, and approves the second draw-down of SDR 301 million (about $3.7 billion and $340 million respectively).

May 24:

Drawings effected by the Bank of Mexico under the three tranches of the $925 million BIS bridging facility are renewed until August 23rd, 1983, on which date the facility expires.

May 31:

The Bank of Mexico makes an advance repayment of $160 million against the BIS bridging facility, leaving a balance of $765 million outstanding.

June 3:

Mexico draws the $340 million EFF financing approved on May 23rd.

Brazil's debt restructuring, 1982-83

1982

August:

From late August Brazilian banks begin losing deposits in the international interbank market. Subsequently, the authorities delay announcing a drop of almost $2 billion in official reserves during September.

October 25:

The Brazilian government announces that after the federal assembly elections on November 15th, it will seek conditional IMF assistance and a

"jumbo" medium-term Eurocredit of an undefined amount, but sufficient to keep it out of the markets for six months.

November:

The president of the central bank visits Washington and New York to try to arrange between $2 and $3 billion of short-term bridging finance from US banks and goes on to London, Frankfurt, Zurich and Paris to seek matching assistance from European banks. However, no new financing is immediately forthcoming as a result of these visits. During this period, Brazil makes its first approach to the IMF.

November 26:

The finance minister says Brazil is seeking an agreement with the IMF, but gives no details and the statement is interpreted internationally as one made mainly for its "demonstration effect".

November 30:

The central bank telexes 15 international commercial banks, modifying its request for up to $6 billion of bridging finance sought in the US and Europe earlier in the month, to a request for $2.4 billion of bridging finance to the end of 1982. Again, there is no immediate response.

December 1:

The US Treasury announces the provision of $1.2 billion of bridging finance to the Brazilian Treasury, pending the agreement of a programme by Brazil with the IMF.

December 12:

The Brazilian authorities announce that an agreement in principle has been reached with the IMF and that a letter of intent will be published on the 17th, but the amount of IMF assistance being sought is not indicated.

December 17:

Letter of intent published indicating that more than $5 billion is being sought from the IMF.

December 20:

The president of the Brazilian central bank makes four requests of four groups of commercial bankers at the Plaza Hotel, New York:

(i) provision of $4.4 billion of new money to cover Brazil's anticipated financing needs for 1983, on proposed terms of 8 years, including 2½ years' grace, a fee of 1½ per cent and a margin of 2⅛ rising to 2½ per cent over Libor, or a margin of 1⅞ rising to 2¼ per cent over US prime;

(ii) rescheduling of $4 billion of principal repayments due in 1983 on public and private sector external debt on the same

terms as proposed for the new financing in (i), above;

(iii) restoration of trade-related short-term credit lines to $10 billion, representing their level at June 30th 1982;

(iv) restoration of interbank deposits to their level at June 30th, or December 31st, 1982, whichever is higher. Unlike the Mexican authorities, those in Brazil did not act to stem a contraction of interbank deposits, which fell from about $10 billion at mid-1982 to about $6½ billion by the end of the year, with a further fall to about $5½ billion by mid-February 1983. Instead, Brazil was here trying to claw back interbank money. By June, 1983, interbank lines had still not been restored to more than about $6 billion.

At the Plaza meeting, four distinct groups of 11 banks each were formed to pursue each of the four objectives outlined with about 700 international banks. Morgan Guaranty led a group to pursue objective (i), Citibank to pursue objective (ii), Chase Manhattan (iii) and Bankers Trust (iv).

December 24:

BIS approves $1.2 billion of bridging finance to be repaid in equal instalments at the end of February, May and August 1983.

December 31:

Approval is announced of $2.2 billion of bridging finance from American, European and Japanese banks, as a result of requests made during the course of November, initially for up to $6 billion, later modified to $2.4 billion. The terms are 1 per cent over Libor, or ¾ per cent above prime, for 90 days.

1983

January 3:

Brazil announces that it will suspend all repayments of principal due in 1983 on public sector medium and long-term debt, officially estimated at $4.7 billion, compared with an earlier estimate of $4 billion. This unexpected announcement takes the place of the rescheduling proposed as objective (ii) at the Plaza Hotel only two weeks earlier and is read by the financial community as a shift from the "market approach" attempted by Brazil thus far.

January 6:

Letter of intent signed with IMF.

January 24:

The first centralized liaison committee of banks newly formed to replace the four distinct groups of 44 banks created a month earlier, meets in

London. Some of the 16 banks invited do not attend, while others send representatives uninvited because of their membership of the four groups created previously. Because interbank lines to Brazil are not being restored as hoped, this meeting decides that names of recalcitrant banks will be published if necessary to ensure a sufficient response to objective (iv), as set out at the Plaza meeting on December 20th.

January 24:

The managing director of the IMF says he will not recommend Brazil's request for assistance to the Fund's executive board unless interbank lines to Brazil are restored in full to the level of about $10 billion outstanding at mid-1982, as under proposal (iv) at the Plaza meeting. This marks a distinct shift by the IMF in making complementary financing by commercial banks a condition of its assistance, as in the case of Mexico.

January 26:

The Saudi Arabian Monetary Agency, SAMA, announces $250 million of bridging finance to complement the $1.2 billion of BIS financing approved on December 24th; the SAMA contribution is drawn down at once.

February 7:

The Brazil liaison committee, meeting in New York, modifies the requirement that interbank lines be restored in full to the approximately $10 billion outstanding at mid-1982, requiring instead that the total be restored only to 87 per cent of that level.

February 18:

Brazil requests a postponement of the first repayment of $400 million due to the BIS at the end of February; the BIS agrees to accept a postponement only to March 15th.

February 25:

At a meeting with the liaison committee in New York agreement is signed providing $4.4 billion of new financing for 1983, representing the achievement of objective (i) set at the Plaza Hotel meeting on December 20th. Agreement is signed also on the rescheduling of $4.7 billion of 1983 repayments of principal on public sector medium and long-term debt, suspended on January 3rd. The terms of the new financing and the rescheduling are for 8 years, including 2½ years's grace, a fee of 1½ per cent, and a margin of 2½ rising to 2½ per cent over Libor, or 1⅞ to 2¼ per cent above US prime, at the borrower's option.

February 28:

Following the agreements signed with commercial banks three days earler, the IMF approves $4.8 billion of financing under its Extended Finance

Facility, or EFF, and under Brazil's first credit tranche, plus another $550 million under its Supplementary Financing Facility, the SFF.

March 3:

The US Treasury announces a new $400 million bridging facility until the first drawdown of the $4.4 billion of new financing agreed with commercial banks on February 25th.

March 10:

Brazil makes its first drawing of $2.5 billion on the $4.4 billion arranged with commercial banks on February 25th and repays in full the $400 million obtained from the US Treasury on March 3rd. At the same time, commercial banks agree to defer until the end of 1983, repayment of half the $2.2 billion of bridging finance they provided under the agreement of December 31st.

March 15:

The first repayment of $400 million is made to the BIS as due, under the two-week postponement agreed with the BIS on February 18th. This reduces to $800 million the $1.2 billion of bridging finance from the BIS announced on December 24th. Under the original arrangements, the remaining repayments of $400 million each fall due at the end of May, and August, 1983.

May 6:

After weeks of speculation, the authorities admit that end-March IMF programme targets have been breached.

May 18:

The authorities conceded that the second tranche of IMF funds, totalling some $400 million and due from May 31st, will be delayed.

May 24:

Banks decide to postpone a further, disbursement of $634 million of their $4.4 billion loan, owing to Brazil's non-compliance with its IMF programme.

June 7:

The Bank for International Settlements announces that a further repayment of $400 million under its facility to Brazil, due on May 31st, has been postponed until the end of June.

June 9:

The authorities introduce a package of measures to cut the federal budget deficit further, from 5.8 to 3 per cent of gdp. In 1981-82, the total public sector deficit had been more than 12 per cent of gdp.

The Paris Club

The Paris Club is the forum within which countries negotiate the restructuring of public sector debt owed to the 17 governments of the DAC, or Development Assistance Committee of the Organization for Economic Cooperation and Development, the OECD.* Debt restructured in this forum consists of loans from the creditor governments, and private export credits which are guaranteed or insured by export credit agencies in the creditor countries.

The origins of this forum go back to the restructuring of some Argentinian debt in 1956 and again in 1961 and 1962, when some Brazilian debt was similarly restructured. The Club has no written rules, but a set of procedures has developed on the basis of trial and precedent over the years. Although the 'club' has met at premises provided by French Treasury from the first, its creditor country members hesitated until 1974 before appointing a small secretariat to which debtor countries might make their first approach, for fear that the very existence of such a secretariat might encourage more applications for debt rescheduling.

The Paris Club came into being because creditor countries wished to establish common terms and conditions for debt restructuring applications, instead of attempting sets of bilateral arrangements with debtor countries and this, indeed, was perceived by the debtor countries as being in their own interests as well.

From a fairly early stage creditor governments met on their own to decide the merits of applications for restructuring and they still do so. But initially the creditor governments themselves judged whether debtor countries were making adequate efforts to adjust their economic policies, although that task has been allotted to the International Monetary Fund from the mid-1970's. Under the procedure as it now exists, meetings of the Paris Club are convened to consider restructuring application only after the debtor country has first agreed an adjustment programe entitling it to the use of conditional upper credit tranche financing from the IMF.

In terms of procedure, some fairly rigid rules have evolved. Once an IMF programme has been agreed and a restructuring application accepted for consideration, an oral presentation is made by the debtor country in Paris explaining the origins of its problems, the adjustment measures being taken and the terms of relief being sought. Representatives of the IMF discuss the adjustment policies already adopted, representatives of the World Bank evaluate the country's longer term development strategies and prospects, and representatives of UNCTAD, the United Nations Conference on Trade

* The members of the DAC are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, the UK, US and the Commission of the European Economic Communities.

and Development, attend as 'friends of court' for the applicant country.

With few exceptions, relief has been confined to the restructuring of repayments of principal falling due within the 'current period' of up to 2½ years, including the time at which debt relief is requested. Repayments of such principal is commonly allowed to be stretched over an extended period of 8 to 10 years, the first half of which is usually conceded as a 'grace period' during which no principal repayments are required. However, creditor countries usually insist that interest payments be maintained and indeed at a 'moratorium rate'. This is a market rate of interest and is usually above that at which the loans were originally contracted, although it can sometimes be below the original lending rates.

Compromise has evolved out of a long difference of opinion between debtor countries seeking long term 'structural relief' and the opposite view consistently put forward by creditor governments, that the debtor countries should adjust promptly and that relief should be given only to the extent necessary to tide borrowing countries over short-term 'liquidity' difficulties.

The compromise is that creditor countries of the Paris Club have come to agree to consider future requests for debt relief under a 'good will clause' provided that the debtor country continues to meet in full the adjustment programme agreed with the IMF and that new restructuring will be considered only for debt which has not previously been the subject of relief.

Over the years, Paris Club agreements have come to include two provisions intended to provide equal treatment for all creditors. The agreements require that debtor countries should seek to restructure debt to non-DAC governments and private creditors, essentially international commercial banks, on terms no more favourable to such creditors than those agreed with the DAC. While those requirements have tended to be met in more cases, they are still not met in all. Debtor countries are required, in practice, to show that they have sought to restructure debt to non-DAC creditors but not, necessarily, that they have succeeded in doing so. This means that sometimes non-DAC debt continues to be fully serviced.

Until 1978, commercial bank debt restructuring agreements linked formally to Paris Club reschedulings or those which informally took place at about the same time were confined to countries that were indebted only partly and in most cases only marginally, to the banking system and whose external debt was in any case minimal in terms of the global banking system's international assets, let alone total assets. The first breaking of this pattern came with the renegotiation of large amounts of Turkish debt to the banking system from 1979 onwards. It was only in 1982, however, that countries externally indebted mainly to the banking system restructured external debt to banks without having approached the Paris Club. Poland led the way, followed by Mexico, Brazil, Argentina, Chile and Uruguay among others.

The approach of commercial banks to the restructuring of sovereign debt has been influenced by practices which have evolved over the past 25 years, although mainly since the mid-1970's. Up to the latter point, the banks tried to confine themselves on the whole to 'refinancing', a term which has now acquired a wider and imprecise connotation, but which was then applied narrowly to the provision of new money which would allow countries in difficulties to go on servicing existing commitments while adjusting their economies. This had the advantage of allowing the creditor banks to continue classifying all such assets, both old and new, as 'performing loans' producing a stream of income. Rescheduling, meaning the granting of new terms for the servicing of existing obligations, was long resisted.

Even during the period when they succeeded in confining themselves to the refinancing of the external debt of troubled countries, as defined above, banks required debtor countries to demonstrate that they were adjusting their economies to bring their balances of payments under better control. However, they did not seek to suggest formally, let alone impose, adjustment policies until 1976, when the financial community required the government of Peru to submit proposals for an adjustment programme and insisted that the financing provided be disbursed in two tranches, to ensure that the programme was being implemented as planned.

Two years later another innovation took place of which Peru was again the subject. Breaking with precedent, commercial banks agreed to restructure a sovereign borrower's existing debt instead of confining themselves to the provision of new money through 'refinancing' which would permit maintenance of service on outstanding liabilities, pending adjustment. Under two agreements during 1978, Peru's external banking creditors agreed to stretch out all principal payments falling due in 1979 and 1980 and some of those falling due in the second half of 1978, for a period of six years. Subsequently, however, Peru found itself able to repay the principal in a shorter period than agreed under the rescheduling, and took this option to obtain new money at less than the penalty lending margins which applied to the stretched out principal repayments.

On the whole commercial banks have tried to confine themselves, like the DAC governments in the Paris Club, to the restructuring or stretching out of the repayment periods of the principal owed to them by foreign borrowers.

The banks have specifically resisted consolidating arrears of principal payments, the stretching out of repayment periods for short-term debt with an original maturity of up to a year, the consolidation of interest arrears and the restructuring of interest payments. However, since 1979 the banks have found themselves obliged to compromise in all those respects in the case of several countries including Turkey, Nicaragua, Togo, Poland, the Sudan and, more recently, a number of others.

The Institute of International Finance, Inc. (the Ditchley group)

The Insitute of International Finance grew out of a meeting attended by the representatives of 31 leading banks from eight countries in New York on October 27th 1982. These bankers, who had previously informally reviewed international financial issues at Ditchley Park, in Oxford, England, agreed to form an institute to promote the exchange of economic and financial information with borrowing countries. According to a press release at the time, the institute is intended also to 'provide a convenient forum through which individual country borrowers can present to lenders information concerning their borrowing needs'.

By January 1983, the IIF had come into being in embryo form with premises in Washington D.C, for easy access to the International Monetary Fund and the World Bank, which have their headquarters there. In June, 1983, it appointed M. André de Lattre as its first managing director and was also recruiting an initial staff of about 15 economists and professional country risk analysts. The Institute hopes for a membership of about 500 international banks which have or propose to have within the immediate future international exposure in their own portfolios for their own risk. Membership is open to all international banks meeting this qualification, whether privately owned or nationalized. However, membership is not open to non-commercial creditors, development and welfare agencies, or banks which act mainly to syndicate loans to other banks (i.e. investment and merchant banks).

The founders of the fledgling Insitute have been adamant from the first that there is no intention of trying to confront borrowing countries with a united front of international banks and have taken pains to avoid giving any impression of becoming a 'bankers' ramp', both for that reason itself and, at a lesser level, to make possible membership of American banks without risk of breaching US anti-trust laws. The Institute's US lawyers have in fact advised that membership of US banks would not in their opinion breach US law.

Because of its position, the Institute has been at pains to stress what it will *not* do as much as what it hopes to achieve. It will not act as a credit rating agency for countries or act as a bargaining agent for representatives of creditor banks in their dealings with borrowers. It will not make political appraisals of debtor countries or provide a means for collective decision making by member banks. Above all: 'It will not be used for presenting borrowers with a united front', according to the decisions formulated at a second meeting of founder banks in New York in January, 1983.

What the Institute will try to provide is prompt and full information on borrowing countries and it will concentrate on filling information gaps,

especially on short-term credits of up to a year. It will seek to present the information in the most neutral way possible to allow member banks to arrive at their own lending decisions, influenced by differences of existing exposure and the views taken by individual banks, which will cause them to react differently to information presented uniformally to all of them.

In pointing to the need for prompter information, especially on short term credits, a spokesman for the Institute said in an interview for this study that such information might have helped bring Mexico's difficulties to light at an earlier stage, thus making them more managable, because individual banks providing more short term interbank funds to Mexico in the months preceding the crisis could persuade themselves that this was happening because they were acting more competitively, in the absence of the knowledge that other banks were similarly increasing their interbank deposits to Mexican banks. The Institute therefore hopes to persuade supervisory authorities like the Bank of England and the Office of the Comptroller of the Currency in the US to make aggregated estimates of short-term credit flows available more promptly on a provisional basis, and would welcome such a development even if the estimates were issued publicly rather than made available to the Institute alone.

The Institute envisages staff missions to borrowing countries which invite such missions. The object will be to gather information on current trends and any information which the host countries may wish to provide on their plans and prospects. It is envisaged that such staff missions will feel less constrained than individual bankers seeking to build up their own lending to the host country and that the attitude of host governments to the missions will likewise differ in some respects from the attitude adopted towards individual visiting bankers. Staff missions may be followed by visits from members of the board of the Institute in the case of countries wishing to discuss their policies, prospects and needs more fully.

Information gathered by missions of staff and directors of the Institute will be made available to the full membership of the Institute as promptly as possible.

While the objective of country missions by a staff envisaged at an initial total of about 15 professionals may sound ambitious, such missions would in fact be concentrated on no more than a handful of sovereign borrowers heavily dependent on commercial bank finance, as distinct from the staff missions regularly sent each year by the International Monetary Fund for consultation with all of the IMF's 146 member countries.

One of the important objectives of the Institute as seen by its founders is to make a full range of information available on equal terms to regional and smaller banks which do not have the resources to gather such information for themselves and whose international lending decisions have often been

influenced in the past largely by the view of banks managing international lending syndicates. The hope is that this may give regional and smaller banks the feeling and reality of a closer, more direct and individual role in the international lending process.

Publications

Policy Statement:

The Problem of Exchange Rates
The Group of Thirty

Study Group Reports:

Toward a Less Unstable International Monetary System
The Reserve Assets Study Group

Foreign Exchange Markets Under Floating Rates
The Exchange Markets Participants Study Group

Balance-of-Payments Problems of Developing Countries
The Capital Movements and the Growth of International Indebtedness Study Group

The Outlook for International Bank Lending
The Capital Movements and the Growth of International Indebtedness Study Group

Reserve Currencies in Transition
Robert V. Roosa, et al

How Central Banks Manage Their Reserves
The Multiple Reserve Currency Study Group

How Bankers See The World Financial Market
International Banking Study Group

Risks in International Bank Lending
International Banking Study Group

Bank Supervision Around the World
Richard Dale

The IMF and the Private Markets
Committee on International Banking

The Future of the International Oil Market
Edwin A. Deagle, Jr.

Occasional Papers:

1. Exchange Rates, Domestic Prices, and the Adjustment Process
   Peter B. Kenen and Clare Pack
2. Credit Creation in the Euromarket:
   Alternative Theories and Implications for Control
   Alexander K. Swoboda
3. View oi Inflation in the United States
   Herbert Stein
4. Energy in the 1980s – An Analysis of Recent Studies
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Group of Thirty

Foreign direct investment 1973-87

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A survey of international companies

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Foreign direct investment 1973-87

FDI trends and outlook

Almost a third of a widely representative sample of major international companies which have cooperated with the Group of Thirty in this study of worldwide foreign direct investment expect their own international investment to increase by more than 25 per cent in real terms during the present five years through 1987. Nearly all of them plan at least some real increase in their global direct investment during that period.

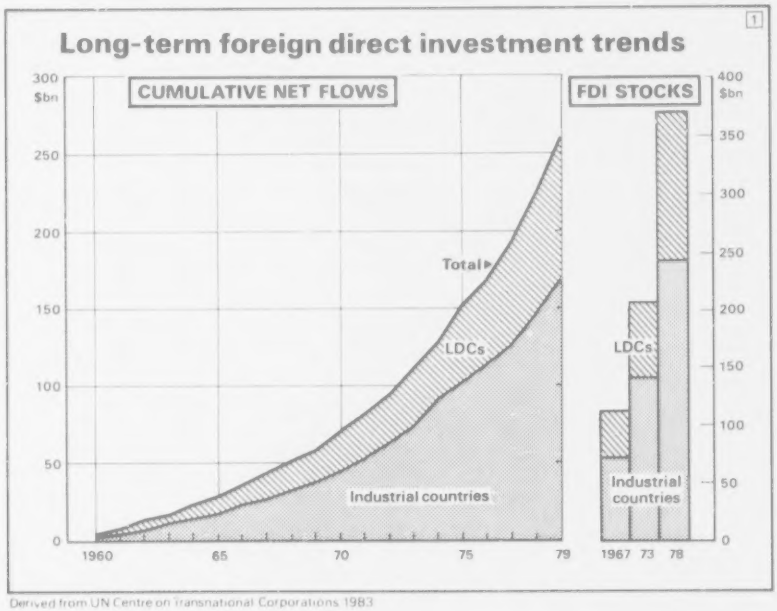
The study is the most comprehensive of its kind yet attempted of the view taken by many of the world's leading international companies of their investment plans and the influences on their investment decisions.

If the intentions reported here are translated into actual investment, there would be some slowing down from the pace of the two preceding five-year periods, during each of which about half the companies participating in this survey increased their real foreign direct investment by 25 per cent or more. However, the real increase planned for the present five-year period by the respondent companies would nevertheless be substantial. And, in relative terms, such investment may come to represent a more important channel for the flow of savings from surplus to deficit countries following the marked contraction of international bank lending to industrial and developing countries since the emergence of international debt-servicing difficulties in mid-1982.

The renewed importance of international direct investment for the world economy justifies public interest after more than a decade during which the contribution of such investment was overshadowed by a growing volume of international bank lending. In the past year, the value of international direct investment has been accorded fresh recognition by President

Reagan, the World Bank and the Organization for Economic Cooperation and Development, among others. As Mr de Larosière, managing director of the International Monetary Fund, said on December 15, 1983: "Foreign direct investment could play a far greater role in resource transfers than in the past."* That recognition has found practical expression, also, in the more welcoming attitude which some developing countries have come to adopt towards international companies. Although about two-thirds of the gross total of international direct investment is made in the mature industrialized countries, the substantial minority of such investment in the broadly defined developing countries tends to make a relatively greater contribution to their economic growth and the growth of their net foreign exchange earning capacity. To quote Mr de Larosière again: "Not only does such investment avoid creating an overhang of debt, it often facilitates the transfer of technology and skills and is directly tied to productive investment."

The possibility that international direct investment may already have started to recapture new importance has been the principal motive for this study by the staff of the Group of Thirty, conducted in 1983 with the generous help of 52 international companies which control and manage almost half the world's stock of foreign direct investment, the total of which is very roughly estimated at between $500 and $550 billion**.



Derived from UN Centre on Transnational Corporations 1983

*In a speech to the Economic Club of Chicago.

**A detailed breakdown of the respondent companies by their home countries, industries, aggregate sales and assets is provided on page 18.

This study has been undertaken, also, in the hope of contributing in another way, because direct investment trends and prospects as viewed by international companies themselves have a timeliness and a broader perspective than captured by official data. The World Bank and the DAC, or Development Assistance Committee of the OECD's aid-donating countries*, both concentrate, by the nature of their functions, on the lesser portion of total direct investment flows which go to developing countries. The OECD itself publicly reviews direct investment trends within the industrial countries only periodically (as in "Economic Outlook" No. 32, December, 1982). The UN Centre on Transnational Corporations attempts estimates of direct investment flows on a worldwide basis among industrial and developing countries, but difficulties of collecting and reconciling information from about 150 member countries helps to explain why its published data tend to be four or even five years out of date**. Moreover, some of the published data are logically inconsistent in appearing to show that a large part of international direct investment, as presently measured on a net basis, seems to disappear from the face of the earth. The one recommendation which this report makes is therefore that the importance of international direct investment justifies an improvement in the collection and publication of official information on such investment.

The credence that can be given to a study like the present one depends partly on the extent to which the evidence of the respondents can be reconciled with official data on past trends. In that respect a close relationship can be seen in three important areas.

First, then, the answers to Question 4, possibly the most important in the questionnaire, suggest that the real increase in international direct investment may be significant in the present five years through 1987, even if less than in the preceding five years, because the strong rise reported by respondents for the previous ten years is supported by the available data on gross flows, as shown in Table 1. Because of the deficiencies in data on net flows, for which some explanations are suggested in the "Recommendation" (on page 16), gross flows are probably the best available measure of new international direct investment.

In their answers to Question 4, about 30 per cent of the respondents

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*The members of the DAC are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, New Zealand, Norway, Sweden, Switzerland, UK, US and the Commission of the European Communities.

**"Salient Features and Trends in Foreign Direct Investment", UN Centre on Transnational Corporations, 1983, is based mostly on data going only to 1979 and some going only to 1977.

reported a real increase of 50 per cent or more in their FDI during 1973-77 and half the respondents reported an increase of 25 per cent or more. A still larger proportion of respondents reported increases of those magnitudes from 1978-82, which included the three-year global disinflation which began in 1979. Crudely deflated by US wholesale prices, the real increase in global FDI flows during the decade to 1979 was about 55 per cent, suggesting that some slowing down from that rate would still represent a significant increase in the present period.

Table 1
Gross FDI flows
$ millions

Into the following regions:

	U.S.	W. Europe	All industrial countries*	LDCs	Global Total	Percent of total going to LDCs
1960	315	749	2,150	1,806	3,956	*46*
1961	311	1,573	2,815	1,839	4,654	*39*
1962	346	1,598	2,790	1,469	4,259	*35*
1963	231	1,819	2,836	1,659	4,495	*38*
1964	322	2,255	3,412	1,819	5,231	*35*
1965	415	2,652	4,227	2,488	6,715	*37*
1966	425	2,878	4,504	2,159	6,663	*33*
1967	698	2,893	4,791	2,103	6,894	*30*
1968	807	2,646	4,735	2,900	7,635	*38*
1969	1,263	3,300	5,928	2,804	8,732	*32*
1970	1,464	4,200	7,522	3,689	11,211	*33*
1971	367	4,892	7,523	3,307	10,830	*31*
1972	949	5,925	8,702	4,234	12,935	*33*
1973	2,800	8,054	11,688	4,719	16,407	*29*
1974	4,760	9,962	16,965	1,123	18,088	*6*
1975	2,603	7,244	11,153	10,494	21,647	*49*
1976	4,347	5,611	10,791	7,824	18,615	*42*
1977	3,338	8,972	13,851	9,500	23,351	*40*
1978	7,900	10,470	20,978	11,154	32,132	*35*
1979	9,730	9,403	22,098	13,491	35,589	*38*
						35**

Source: UN Centre on Transnational Corporations, 1983. *Besides flows into the United States and Europe includes mainly those into Canada and Australia. Flows into Japan averaged well below $100 million a year throughout. **Average for period.

Secondly, Table 1 seems to support the views expressed by a number of respondents on the infuluence of exchange rate changes on direct investment and the lure of "safe" locations. From 1970 through 1979, the dollar's effective or trade-weighted exchange rate declined steadily by just over 20 per cent, on the International Monetary Fund's calculations. After a lag, that longer-term exchange rate *trend* produced a reversal of the *défi Américain* by attracting an increasing volume of gross direct investment flows into the US. However, the steep rise in dollar interest rates which contributed to a 26 per cent recovery in the effective dollar exchange rate from 1980 to 1982 had a very different effect in attracting huge intra-company financial flows. Some companies interviewed denied strongly that they deploy cash balances as international investment portfolios. That, however, is clearly untrue of some. The British subsidiary of a major American international company recorded almost as much pretax profit from interest on funds lent to its US parent as it did from a successful sales record in 1982. The secretariat of the OECD remarked at the end of 1982:

> "Direct investment to and from the United States recently appears to have behaved somewhat more like financial capital; large interest differentials in favor of the United States and expectations of a strong dollar reportedly resulted in heavy foreign borrowing and repatriation of funds by United States corporations through their subsidiaries and financial affiliates"*.

In summary, longer-term exchange rate trends do seem to influence foreign direct investment flows, while short-term exchange rate fluctuations seem to stimulate intracompany financial flows, but not necessarily a corresponding investment in new plant and equipment (which fits with the answers of several respondents to our question on "the influence of exchange rates" summarized on page 36).

Third, the published data confirm the large proportion of foreign direct investment concentrated in the mature industrialized countries. The companies which cooperated in this study have held about 75 per cent of their total foreign assets in the mature industrial countries since 1977 (compared with just over 80 per cent in 1972 and an anticipated 77 per cent by 1987). Table 1 shows that during the 20 years through 1979, an average of 35 per cent of total international direct investment flows went to the developing countries. While it is true that stocks and flows are not identical, the discrepancy between the 35 per cent of FDI flows reported as going to LDCs and the approximate 25 per cent of their own FDI stocks reported by

*OECD "Economic Outlook", December 1982, p. 57

the companies cooperating in this survey as being held in the LDCs, has two explanations. One is that the proportion of new FDI financed locally is relatively smaller in the LDCs, thus explaining relatively larger flows into them, as compared with the level of their FDI stocks. Secondly, companies engaged in the exploitation of natural resources are less fully represented among those cooperating in this study than they are in the totality of international investment in LDCs.

The consistent contribution that FDI flows have made to developing countries is especially important. Although FDI flows declined from almost 60 per cent to only 20 per cent of net private flows to LDCs during the 20 years to 1980, they are now projected to rise again to about a third of private flows by 1984. On one set of World Bank projections, they could rise to 40 per cent of private flows by 1995*. Those changes and projected changes partly reflect fluctuations in the relative importance of other capital flows, especially bank lending. But underlying those relative changes is an almost consistent contribution of about 20 per cent made by foreign direct investment flows to the total of net capital flows to LDCs.

Summary Table A (Questions 1 and 2)

FDI trends during the recent recession in:

	respondents' companies	respondents' industries
	(per cent of respondents)	
"substantial" increase	*44*	*28*
"some" increase	*29*	*38*
no change or decrease	*27*	*34*
	100	*100*

*World Bank Development Report, 1983, IBRD, July 1982, p. 33.